

**DEPARTMENT OF CORPORATIONS**  
*California's Investment and Financing Authority*

IN REPLY REFER TO:  
FILE NO: OP 6978-FIL

January 12, 2006

**COMMISSIONER'S OPINION 06/1F**

THIS INTERPRETIVE OPINION IS ISSUED BY THE COMMISSIONER OF CORPORATIONS PURSUANT TO CORPORATIONS CODE SECTION 31510 OF THE FRANCHISE INVESTMENT LAW. IT IS APPLICABLE ONLY TO THE TRANSACTION IDENTIFIED IN THIS OPINION REQUEST, AND MAY NOT BE RELIED UPON IN CONNECTION WITH ANY OTHER TRANSACTION.

Keith W. McBride  
Diepenbrock Harrison  
400 Capitol Mall, Suite 1800  
Sacramento, CA 95814

Re: Van De Pol Enterprises, Inc.

Dear Mr. McBride:

The request for an interpretive opinion contained in your letter dated November 10, 2004, and as supplemented by your correspondence dated April 28, 2005 and November 21, 2005, has been considered by the Commissioner of Corporations.

**I. Question**

Your letter raises the question of whether your client, Van De Pol Enterprise, Inc. (hereinafter "VDP"), must meet and disclose the minimum net worth requirements including the financial statements and a guarantee as specified in Corporations Code Section ("Section") 31101(a) of the Franchise Investment Law ("the Law"), as a condition to claiming the exemption from registration under Section 31104. We conclude these net worth and disclosure requirements are inapplicable for the following reasons.

♦ Securities ♦ Franchises ♦ Off-Exchange Commodities ♦ Investment and Financial Services ♦  
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## II. Background

You represent the following facts:

- VDP is a wholesale distributor of petroleum products that proposes to offer and sell petroleum products to retail service stations to purchase and resell these petroleum products under brand names to public consumers.
- The contemplated petroleum supply contracts will likely constitute franchises under the Law.
- If the petroleum supply contracts do constitute franchises, VDP will be subject to registration and compliance under the Law, unless an exemption applies.
- The exemption provided by Section 31104 of the Law appears directly applicable to the activities contemplated by VDP.
- In order to qualify for the Section 31104 exemption, a franchisor must meet the requirements of Subdivisions (a) and (b) of that section. Specifically, Section 31104(b) contains a cross-reference to Section 31101(c) requiring the delivery of certain disclosures to prospective franchisees.
- This cross-reference to Section 31101(c) raises confusion as to the required minimum net worth and disclosures necessary to qualify for exemption from registration afforded by Section 31104.

## III. Ambiguous Statutory Language

Section 31104 provides petroleum corporations or distributors an exemption from the registration requirements as set forth in Chapter 2 (commencing with Section 31110) of the Law. Although the Section 31104 exemption does not expressly contain a minimum net worth requirement, Section 31104(b) provides that to qualify for the exemption, a franchisor must comply with the “provisions of subdivision (c) . . . of Section 31101.” The current version of Section 31101(c) requires a franchisor to disclose to prospective franchisees the information and documents listed in (c)(1)(A) – (c)(1)(P). Subdivision (c)(1)(O) of Section 31101 provides for disclosure of a copy of the financial statement or statements required by Section 31101(a); and likewise, subdivision (c)(1)(P) includes disclosure of a copy of the unconditional guarantees, if applicable, required by Section 31101(a).

Under Section 31101(a), a franchisor has three available options to satisfy the minimum net worth requirement:

1. The franchisor has a net worth on a consolidated basis of not less than five million dollars (\$5,000,000), according to its *audited* financial statement.
2. The franchisor has a net worth of not less than one million dollars (\$1,000,000) and its parent has a net worth of five million dollars (\$5,000,000), according to the *audited* financial statements of the franchisor and its parent, respectively.

3. The franchisor has a net worth of one million dollars (\$1,000,000), according to its *unaudited* financial statement, and the parent has a net worth on a consolidated basis of not less than five million dollars (\$5,000,000), according to its *audited* financial statement, and the parent absolutely and unconditionally *guarantees* to assume the duties and obligations of the franchisor under the franchise agreement should the franchisor become unable to perform its duties and obligations.

Section 31104(a) includes a cross-reference to Section 31101(c) which, in turn, specifically references certain disclosures of financial statements and an applicable guarantee in Section 31101(a). It is this subsequent reference to Section 31101(a) that causes an ambiguity because it is unclear whether a franchisor claiming the Section 31104 exemption must meet and disclose a minimum net worth, including the financial statements and applicable guarantee.

#### IV. Construing Statutes to Accomplish Their Purpose

Due to the ambiguity in the Law, examination of the statute's purpose and exploration of the rules of statutory construction must be undertaken. Generally, statutes are to be given their plain or literal meaning. (*People v. Smith* (2003) 110 Cal. App. 4<sup>th</sup> 492.) However, where the provisions of a statute are ambiguous or conflict, statutory construction is to be utilized. (*Santa Ana Unified School District v. Orange County Development Agency* (2001) 90 Cal. App. 4<sup>th</sup> 404.) The cardinal rule of statutory construction is to ascertain the intent of the Legislature so as to effectuate the purpose of the law. (*Palmer v. GFT California, Inc.* (2003) 30 Cal.4<sup>th</sup> 1265.) The legislative intent behind the statute supersedes a strict reading of the statutory text. (*In re Potter's Estate* (1922) 188 Cal. 55; *California School Employees Association. v. Jefferson Elementary School District* (1975) 45 Cal. App.3d 683.) Once the legislative intent has been ascertained, a statute must be given a reasonable construction, which conforms to that intent, even though it may not be consistent with the strict letter of the statute. (*Alameda County v. Kuchel* (1948) 32 Cal.2d 193.) If following the plain meaning of a statute would inevitably frustrate the manifest purpose of the legislation or lead to an absurd result, a literal interpretation may be rejected. (*People v. Belleci* (1979) 24 Cal. 3d 879.)

The canons of statutory construction provide that "where a statute adopts by specific reference the provisions of another statute.... such provisions are incorporated in the form in which they exist at the time of the reference" so that a subsequent addition to, or modification of, the provisions referred to does not affect the adopting statute, absent a clearly expressed intention to the contrary. (*Palermo v. Stockton Theatres, Inc.* (1948) 32 Cal. 2d 53, 58-59.) When enacted in 1976, Section 31104 included the cross-reference to Section 31101(c); however, at that time subdivision (c)(1)(O) and (P) had not yet been amended into Section 31101. (Cal. Corp. Code §31104, added by Stats. 1976, Chap. 1410, §1.)

Subdivisions (c)(1)(O) and (c)(1)(P) were subsequently added to Section 31101 by Assembly Bill 2135 (Chapter 1026, Statutes of 1989). There is no clearly expressed legislative intention to incorporate (c)(1)(O) or (c)(1)(P) into the requirements of the Section 31104 exemption. The legislative history behind AB 2135 is void of any mention of Section 31104 including its reference to Section 31101(c). Nor does the legislative history of Section 31101(c)(1)(O) and (P) discuss the application of these provisions to Section 31104. (Senate Insurance, Claims and Corporations Committee on Assembly Bill No. 2135 (1989) July 19, 1989.) Had the Legislature intended the minimum net worth requirements of Section 31101(a) and the related disclosure of financial

statements and a guarantee to apply as conditions of exemption under Section 31104, those requirements would have been expressly included into the statutory language of Section 31104.

This interpretation is consistent with the original intent of Section 31104, which was added by Assembly Bill 3463 (Chapter 1410, Statutes of 1976). The legislative history behind Section 31104 indicates that the purpose of that section is to exempt qualifying franchisors from specified requirements of the Law – the minimum net worth and disclosure of audited financial statements – that are mandatory under the Section 31101 “large franchisor” exemption. (Assembly Committee on Resources, Land Use, and Energy on Assembly Bill No. 3463 (1976) May 10, 1976.) Furthermore, the Section 31104 exemption is intended to provide relief to qualifying small-scale petroleum wholesalers or “jobbers” from the financial burden of obtaining costly audits of financial statements. (*Ibid.*)

A letter from the author of AB 3463 to then Governor Brown stated that “AB 3463 would exempt a jobber and wholesaler from the unnecessary provisions of Section 31101(c) of the Corporations Code,” such as “obtaining audited financial statements at an estimated maximum cost of \$10,000.” (Assemblyman Vic Fazio, letter to Governor Brown regarding Assembly Bill No. 3463 (1976) Sept. 13, 1976.) Even the Department of Corporations noted in a letter to the author of AB 3463 that “[t]he effect of [AB 3463] would be to exempt oil distributors from the net worth and business experience requirements, and more particularly, not require oil distributors to provide audited financial statements to their franchisees.” (David C. Woods, Legislative Coordinator for the Department of Corporations, in a letter to Assemblyman Vic Fazio, July 13, 1976.)

## **V. Conclusion**

Based on the foregoing, we conclude that your client, VDP, is not required to meet and disclose the minimum net worth requirements including the financial statements and guarantee as specified in Corporations Code Section 31101(a) of the Law, as a condition to claiming the exemption from registration under Section 31104.

Our reading of the Section 31104 exemption requirements harmonizes and carries out the intent of both statutory exemptions. The Section 31101 exemption was created to remove qualifying “large franchisors” from the registration requirements of the Law, as specified, by meeting a minimum net worth and disclosing certain information demonstrating that net worth. While the Section 31104 exemption was also added to provide an exemption from registration for certain franchisors, this section does not require VDP to meet the net worth requirements of Section 31101(a) or to disclose the financial statements or guarantee referenced in Section 31101(a), as discussed above.

This opinion is limited to the facts as specifically represented to the Commissioner in your correspondence. Any change in the facts as represented in your correspondence may compel a different conclusion. This reading of Section 31104 does not alleviate a franchisor from complying with any other requirements of Section 31104, and Section 31101(c) and (d) by cross-reference, including disclosure of information pursuant to Section 31101(c)(1)(A) – (c)(1)(N), or any other law in connection with the offer and sale of franchises.

Dated: January 12, 2006  
Sacramento, California

WAYNE STRUMPFER  
Acting California Corporations Commissioner

By \_\_\_\_\_  
TIMOTHY L. Le BAS  
Deputy Commissioner and General Counsel  
Office of Law and Legislation  
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November 10, 2004

Mr. Timothy L. LeBas  
Deputy Commissioner/General Counsel  
Office of Law and Legislation  
California Department of Corporations  
1515 K Street, Suite 200  
Sacramento, California 95814

**Re: Franchise Investment Law (Section 31104)**  
**Our File No.: 3282-001**

Dear Mr. LeBas:

Our client Van De Pol Enterprises, Inc., a California corporation ("VDP"), is a wholesale distributor of petroleum products that proposes to offer and sell petroleum products to retail service stations to purchase and resale these petroleum products under brand names to public consumers. We have reviewed this activity with VDP and have determined that the contemplated petroleum supply contracts will likely constitute franchises under the Franchise Investment Law (Corporations Code sections 3100-31516, hereinafter "FIL"). We have reviewed the exemptions from legislation provided by the FIL and have determined that the exemption provided by section 31104 appears directly applicable to the activities contemplated by VDP.

## REQUEST FOR INTERPRETIVE OPINION UNDER SECTION 31510.

However, it is necessary to satisfy certain conditions specified in section 31104, particularly those set forth in subsection (b) relating to disclosure, in order to claim this exemption. Two specific questions arise regarding the scope and intent of the disclosure requirements set forth in subsection (b) of section 31104. Firstly, must the petroleum corporation or distributor have a net worth of at least \$5 million? Secondly, must the financial statements of the petroleum corporation or distributor be audited? We are providing this letter to the Commissioner of Corporations to specifically request

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Mr. Timothy J. LeBas

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an interpretive opinion pursuant to section 31510 of the FIL regarding these two questions.

To assist the Commissioner in responding to this matter, we provide the following facts relevant to these questions together with our analysis of these two matters.

## **I. A PETROLEUM CORPORATION OR DISTRIBUTOR NEED NOT POSSESS A NET WORTH OF AT LEAST \$5 MILLION TO QUALIFY FOR THE EXEMPTION PROVIDED BY SECTION 31104 OF THE FIL.**

In order to claim the exemption provided by section 31104 of the FIL, a petroleum corporation or distributor must satisfy certain conditions set forth in section 31104. Section 31104(b) requires the delivery of a disclosure document as described in subdivision (c) of Section 31101 of the FIL. Section 31101 was created to exempt certain "large" franchisors from the registration requirements of the FIL. These franchisors must possess, among other things, a current net worth no less than \$5 million according to the franchisor's most recent audited financial statement. In addition, these "large" franchisors must disclose certain information in writing to each prospective franchisee pursuant to subsection (c) of section 31101. Subsection O thereof requires "a copy of the financial statement or statements required by subdivision (a)." The referenced financial statements must demonstrate that the "large" franchisor in fact possesses the minimum current net worth required for the exemption provided by section 31101.

Section 31104 of the FIL instead applies to petroleum corporations or distributors who are wholesale distributors or marketers of petroleum products. These entities must satisfy certain conditions set forth in section 31104. The petroleum corporation or distributor must have been engaged in this business continuously for the past five years, must not require an advance of funds in the nature of a fee or lease for franchise agreements, and must not be engaged in the production or the refining of petroleum. VDP is a California corporation that has been continuously engaged in the wholesale distribution of petroleum products during the past five years, and VDP satisfies and its contemplated activities will satisfy the conditions set forth in subsections (a) and (c) of section 31104 of the FIL that are imposed on a petroleum corporation or distributor. However, in order to claim the exemption provided by section 31104, the petroleum corporation or distributor must comply with the provisions of subdivisions (c)(1), (c)(2), and (b) of Section 31101. As noted above, subsection (c) of section 31101 sets forth certain disclosure requirements and, impliedly, requires financial statements demonstrating the franchisor delivering the disclosure document has a current net worth of at least \$5 million. VDP does not have a current net worth of at least \$5 million. Section 31104 was not intended to impose this \$5 million net worth requirement on petroleum corporations and distributors. Such a requirement would have been expressly stated in section 31104 if it were intended. Moreover, we

# **THE DIEPENBROCK LAW FIRM**

Mr. Timothy J. LeBas

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understand the vast majority of petroleum distributors are privately owned entities that do not possess such a net worth. It is therefore apparent to us that section 31104 of the FIL should not be construed so as to impose a requirement that petroleum corporations or distributors possess a current net worth of at least \$5 million.

We understand the Department of Corporations has not previously taken a policy position regarding this question. We therefore respectfully request a formal interpretive opinion from the Commissioner of Corporations pursuant to section 31510 of the FIL confirming that a petroleum corporation or distributor as defined in section 31104 need not have a current net worth of at least \$5 million in order to rely upon the exemption provided by section 31104.

## **II. A PETROLEUM CORPORATION OR DISTRIBUTOR NEED NOT HAVE AUDITED FINANCIAL STATEMENTS TO QUALIFY FOR THE EXEMPTION PROVIDED BY SECTION 31104.**

In order to claim the exemption provided by section 31104 of the FIL, a petroleum corporation or distributor must satisfy certain conditions set forth in section 31104. Section 31104(b) requires the delivery of a disclosure document as described in subdivision (c) of Section 31101 of the FIL. Section 31101 was created to exempt certain "large" franchisors from the registration requirements of the FIL. These franchisors must possess, among other things, audited financial statements demonstrating the franchisor satisfies the requirement for a minimum net worth of \$5 million. In addition, these "large" franchisors must disclose certain information in writing to each prospective franchisee pursuant to subsection (c) of section 31101. Subsection O thereof requires "a copy of the financial statement or statements required by subdivision (a)." The referenced financial statements for the "large" franchisor must be audited in order to claim the exemption provided by section 31101.

Section 31104 of the FIL instead applies to petroleum corporations or distributors who are wholesale distributors or marketers of petroleum products. These entities must satisfy certain conditions set forth in section 31104. The petroleum corporation or distributor must have been engaged in this business continuously for the past five years, must not require an advance of funds in the nature of a fee or lease for franchise agreements, and must not be engaged in the production or the refining of petroleum. VDP is a California corporation that has been continuously engaged in the wholesale distribution of petroleum products during the past five years, and VDP satisfies and its contemplated activities will satisfy the conditions set forth in subsections (a) and (c) of section 31104 of the FIL that are imposed on a petroleum corporation or distributor. However, in order to claim the exemption provided by section 31104, the petroleum corporation or distributor must comply with the provisions of subdivisions (c)(1), (c)(2), and (b) of Section 31101. As noted above, subsection (c) of section 31101 sets forth certain disclosure requirements and, impliedly, requires audited financial statements. VDP does not have audited financial statements. Section 31104



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was not intended to impose the requirement for audited financial statements on petroleum corporations and distributors. Such a requirement would have been expressly stated in section 31104 if it were intended. Moreover, we understand the vast majority of petroleum distributors are privately owned entities that do not possess audited financial statements. It is therefore apparent to us that section 31104 of the FIL should not be construed so as to impose a requirement that petroleum corporations or distributors possess audited financial statements that would be included in a disclosure document delivered under section 31104. Commissioner's Rule 310.111.2 provides that financial statements accompanying a disclosure document or franchise offering circular should be audited unless the particular form or section permits the use of unaudited statements for interim periods or generally. Subdivision (d) of Rule 310.111.2 nonetheless states the Commissioner will "in extraordinary cases" waive the requirement for audited statements if the statements have been prepared by an independent certified public accountant or independent public accountant and the Commissioner is otherwise satisfied as to the reliability of such statements and as to the ability of the franchisor to perform future commitments. VDP's unaudited financial statements have been prepared by an independent certified public accountant or independent public accountant and will be provided with a disclosure document otherwise conforming to the requirements of subsection (c) of section 31101 for the inclusion of financial statements of the franchisor. The relevant business relationship described by section 31104 is the sale and delivery by a petroleum corporation or distributor of petroleum products that will be resold by the franchisee without substantially changing their form. The obligations of the franchisee are to purchase and pay for petroleum products delivered to the franchisee's facilities. The delivery of audited financial statements to a prospective franchise is not relevant to the ability of the petroleum corporation or distributor to perform future delivery commitments. The franchisee may deal directly with the refinery or another wholesaler if the petroleum corporation or distributor fails to deliver petroleum products as ordered. A requirement for audited financial statements is not therefore relevant to the business relationship between the parties that is described in section 31104.

We understand the Department of Corporations has not previously taken a policy position regarding this question. There is some discussion in Commissioner's Policy Letter 3 (May 5, 1969) of the Commissioner's concern whether a franchisor possesses sufficient capital to provide the promised goods and services. However, the franchisor in that matter not only subleased the business premises to the franchisee, but the franchisor also was providing the initial inventory for the franchised automotive parts and accessories business. These facts are noticeably distinguishable from those at hand. VDP will not have an interest in the franchisee's premises and will only supply petroleum products to the franchisee, albeit on a slightly discounted basis because of the franchisee's commitment to enter into the franchise relationship. We therefore respectfully request a formal interpretive opinion from the Commissioner of Corporations pursuant to section 31510 of the FIL confirming that a petroleum

**THE DIEPENBROCK LAW FIRM**

Mr. Timothy J. LeBas

November 10, 2004

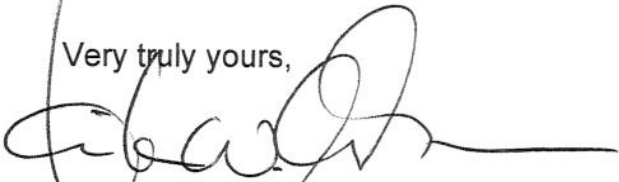
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corporation or distributor as defined in section 31104 need not have audited financial statements in order to rely upon the exemption provided by section 31104.

**CONCLUSION.**

For the reasons set forth above, we do not believe that a petroleum corporation or distributor as defined in section 31104 must have a current net worth of at least \$5 million or must have audited financial statements to claim the exemption provided by section 31104. In this determination, we have not addressed the requirement for filing of a notice with the Commissioner, as indirectly required by subsection (c) of section 31104 in its reference to subsection (d) of section 31101, because VDP intends to satisfy the requirement for the timely filing with the Commissioner of a notice as specified therein. Please contact the undersigned if there is any question or comment regarding these matters. We greatly appreciate the attention given to these matters and await the Commissioner's response to this request for interpretive opinion.

Very truly yours,



Keith W. McBride

KWM:sa

cc: Van de Pol Enterprises, Inc.

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Date: November 21, 2005

Our File: 3282-001

Please Deliver the Following Page(s) Immediately To:

Name:	Tim LeBas
Company:	California Dept. of Corporations
Facsimile No.:	(916) 322-5875
Telephone No.:	(916) 322-3977

From: Keith W. McBride

PAGES (including this cover page): 2

This will confirm our recent discussion that the department issue its interpretive opinion in the matter involving Van De Pol Enterprises. The request relates to those questions posed in our letter of regarding section 31104 of the Franchise Investment Law.

Our initial request of November 10, 2004, was supplemented on April 29, 2005, with the following electronic message to Ms. Dunlap via the Internet:

Dear Ms. Dunlap,

Your secretary Susan confirmed that the request for an interpretive opinion we previously submitted on behalf of our client *Van de Pol Enterprises, Inc.*, has been assigned **OP 8978** for reference purposes. I understand you have not had an opportunity to review this request for an interpretive opinion regarding the disclosure requirements of section 31104 of the Franchise Investment Law.

I am sending this message to inquire informally whether the Department might also conclude that financial statements need not be required at all in a disclosure document from a petroleum distributor that is relying upon section 31104. Distributors deliver petroleum products from a refinery, and a distributor's worth is unrelated to its ability to continue delivery of the petroleum products. I recognize the Department has historically taken the position that financial disclosure should always be provided. This is an exemption where a different approach should be appropriate.

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I will await word from you regarding this matter.

Thank you, Keith McBride

As requested in the message to Ms. Dunlap, it is our view that financial statements distributed under section 31104 need not be required at all in the disclosure document provided by a petroleum distributor relying upon section 31104. Distributors deliver petroleum products from a refinery, and a distributor's worth is unrelated to its ability to continue delivery of the petroleum products. While we recognize the Department has historically taken the position that financial disclosure should always be provided, we submit this exemption is one where a different approach is appropriate.

Our client has informed us that there are no other updated facts to present and that there are no material changes to its business program since the earlier request was presented.

Please also note that this law firm changed its name earlier this year, and we are now known as Diepenbrock Harrison.

IF YOU DO NOT RECEIVE ALL PAGES OR HAVE PROBLEMS RECEIVING THEM, PLEASE CALL (916) 492-5000.